

SWITCH FROM BHARTI TO RCOM

Our recommendation to switch from Bharti to RCOM from a six-month perspective has been vindicated in last two months. We still maintain the same recommendation, though we believe the long-term fundamentals remain intact for Bharti.

KEY HIGHLIGHTS – Q2 FY08

Change QoQ	Bharti	RCOM	Analysis (QoQ)
Wireless subscribers	14.5	13.9	Bharti is still the leader
Wireless ARPU	-6.2	-8.5	RCOM's higher MoU fall led to steeper decline
Wireless revenue	7.7	5.4	Bharti managed the show better due to higher subscriber growth and lesser dip in ARPU
Non-wireless revenue	6.0	-8.1	Similar to Q1FY08, RCOM still under pressure of appreciating rupee
Total revenues	7.3	2.5	RCOM hit by poor non-wireless business
Operating expense	4.9	5.1	RCOM had higher staff and network operations expenses; Bharti lead the way with better cost management
Wireless EBITDA	8.6	-1.4	RCOM's margin declined by 257 bps QoQ
Non-wireless EBITDA	18.4	2.7	Bharti's cost management and revenue growth helped to outperform RCOM
Total EBITDA	10.8	-0.3	Bharti's non wireless business made a good impact
EBITDA Margin	42.8	40.1	Bharti's showed 132 bps QoQ increase; RCOM's declined by 116 bps QoQ
PAT	6.8	8.0	Both had higher depreciation costs
PAT (adj for both forex and deferred tax –P&L items)	10.7	-2.7	RCOM hit by higher financial costs
Bharti is the clear outperformer			

Valuation and Outlook

Both players showed similar trends in the wireless business while in the non-wireless business, revenues for Bharti and RCOM showed divergent trends; Bharti grew 6.0% QoQ as RCOM declined 8.8% for the same period with EBITDA increasing for the two by 18.4% and 2.7% respectively. But overall, Bharti performed better in Q2FY08 on the back of good performance by the non-wireless business with overall EBITDA margin expansion of 132 bps QoQ, while RCOM's EBITDA margin declined by 116 bps QoQ. Bharti has definitely won the quarter on all parameters and has displayed strong fundamentals.

At the CMP(31/10/2006), Bharti is trading at 11.3x FY09E EV/EBITDA, which is at 23% discount to RCOM's 13.9x FY09E EV/EBITDA. The value migration from Bharti to RCOM is apparent during last quarter as Bharti has been trading historically at 10-15% premium to RCOM. This has vindicated our call of RCOM outperforming Bharti in the short to medium term. This is due to uncertain regulatory policies which could affect Bharti in respect of subscriber criteria for additional 2G spectrum allocation and spectrum usage charges.

The whole sector is under the grip of regulatory uncertainty with chinks appearing in wireless growth as all the announced results revealed falling subscriber MoUs and higher operational costs. We still prefer RCOM over Bharti and believe RCOM will trade at premium due to the following event driven triggers

- Value unlocking in subsidiaries like tower business and FLAG
- Expected higher growth opportunities for RCOM due to benign regulatory policy for dual technology use for CDMA players
- Regulatory policy in relation to subscriber criteria for additional 2G spectrum allocation and spectrum usage charges will be detrimental to Bharti's profitability and growth opportunity, as it will increase costs and limit customer servicing capacity. Further Bharti's face off with the regulator would indirectly benefit RCOM.

SNAPSHOT – Q2 FY08

Rs mn	Bharti	% chg QoQ	RCOM*	% chg QoQ
Wireless	50579	7.7	35564	5.4
Carrier/global	10048	9.1	13161	1.0
Broadband & Telephone	10446	13.0	4372	14.1
Others & eliminations	(7699)	20.6	(8978)	18.8
Non wireless	12795	6.0	8555	-8.1
Revenues	63374	7.3	44118	2.5
Access charges& license fees	15598	4.7	9746	0.6
Network op cost	7520	10.2	5662	30.5
Employee costs	3745	6.6	3056	24.0
SGA	9414	0.7	7703	-8.4
Total operating expense	36277	4.9	26167	5.1
Wireless	20728	8.6	13206	-1.4
Carrier/global	3462	9.3	3276	1.1
Broadband & Telephone	4225	29.6	2102	14.5
Others & eliminations	(476)	9.7	(499)	53.5
Non wireless	6369	18.4	4879	2.7
EBITDA	27097	10.8	18085	-0.3
Depreciation & amortisation	9062	11.6	6754	9.1
Finance cost (net)	1126	NA	(1125)	NA
Other income/(loss)	562	-70.1	(13870)	NA
PBT	17471	-7.6	26325	98.8
Tax	1135	-68.4	698	-32.3
Minority interest	197	3.1	12448	NA
PAT	16139	6.8	13179	8.0
Wireless Subscriber (mn)	48.88	14.5	36.32	13.9
ARPU (Rs per month)	366	-6.2	344	-8.5
MoU (minutes per month)	469	-1.9	490	-3.9
ARPM (Rs.)	0.78	-4.4	0.70	-4.8
Minutes on network (bn)	64.4	12.7	50.7	10.7

*RCOM financials adjusted for TDSAT AGR refund Rs. 1667 mn recognized in Q2FY08

Revenues

Bharti's revenue increase at 7.7%QoQ was helped by 14.5% QoQ subscriber growth; but ARPU faced pressure from falling tariff and MoU. RCOM's adjusted ARPU, after removing the TDSAT refund of Rs. 1667 mn, declined drastically by 8.5% QoQ to Rs. 344 with MoU and ARPM declines of 3.9% and 4.8% QoQ respectively.

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ARPM (Rs.)	0.78	-4.4	0.70	-4.8
Minutes on network (bn)	64.4	12.7	50.7	10.7

Non-wireless revenues (including others and net of eliminations) for Bharti grew at 6% QoQ propelled by all three businesses (growth of 7.8%, 9.1% and 25.4% QoQ for Broadband & Telephone, Carriers and Corporate businesses respectively), while RCOM's non-wireless business declined by 8.1% QoQ to Rs. 8555 mn. Though the global business and Broadband & Telephone operations grew at 1% and 14.1% QoQ, intersegment eliminations grew at a faster rate of 18.8%.

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EBITDA

Operations cost (Rs mn)	Bharti	% chg QoQ	RCOM	% chg QoQ
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EBITDA (Rs mn)					EBITDA share		EBITDA margin	
	Bharti	% chg QoQ	RCOM	% chg QoQ	Bharti	RCOM	Bharti	RCOM
Wireless	20728	8.6	13206	-1.4	76.5	73.0	40.1	37.1
Carrier/global	3462	9.3	3276	1.1	12.8	18.1	34.5	24.9
Broadband & Telephone	4225	29.6	2102	14.5	15.6	11.6	40.5	48.1
Others & eliminations	(476)	9.7	(499)	53.5	- 4.9	- 2.8	NA	NA
Non wireless	6369	18.4	4879	2.7	23.5	27.0	49.8	57.0
EBITDA	27097	10.8	18085	-0.3	100.0	100.0	42.8	41.0

Bharti's performance improved on all parameters with EBITDA growth of 10.8% QoQ and margin increase of 132 bps QoQ with Broadband & Telephone business (including Enterprise services – Corporates) growing at 29.6% QoQ. For RCOM, the wireless business EBITDA declined by 1.4% QoQ, while that of non-wireless business increased by 2.7% QoQ. Significant rise in network and employee costs by 30.5% and 24% QoQ led to an overall dip in EBITDA by 0.3% QoQ with a margin dip of 116 bps.

Net profit

Rs mn	Bharti	% chg QoQ	RCOM	% chg QoQ
Depreciation & amortisation	9062	11.6	6754	9.1
Finance cost (net)	1126	NA	(1125)	-11.7
Other income/(loss)	562	-70.1	(13870)	NA
PBT	17471	-7.6	26325	98.8
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Minority interest	197	3.1	12448	NA
PAT	16139	6.8	13179	8.0

Reported PAT growth of Bharti and RCOM were 6.8% and 8.0% QoQ, but PAT figures adjusted for exceptional items and tax aberrations related to P&L items show a different picture. Bharti's adjusted PAT increased by 10.7% QoQ, while RCOM's decreased by 2.7% due higher financial charges.

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